

Alert

New Stimulus Package Creates Subsidy for Health Care Continuation Coverage

March 9, 2009

On Feb. 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (the "ARRA"). The ARRA seeks to stimulate the economy by authorizing approximately \$787 billion in tax cuts and spending for a variety of programs, including health, education and job creation. Of immediate significance to employers, health plans and insurers are provisions that expand the rights of terminated employees under the Consolidated Omnibus Budget and Reconciliation Act of 1985, as amended ("COBRA"). This Alert summarizes the ARRA's changes to COBRA, describes employers' obligations under this new legislation and provides guidance on various notice requirements.

COBRA Premium Subsidy

Pursuant to the COBRA provisions of the ARRA, 65 percent of an "assistance eligible individual's" (as defined below) COBRA premiums will be subsidized by the U.S. government. Thus, an assistance eligible individual is treated as having paid the full premium for health care continuation coverage if he or she pays 35 percent of the premium. While the ARRA requires the employer, COBRA administrator or other plan sponsor to initially front the cost of the remaining 65 percent of the assistance eligible individual's COBRA premium, the government will reimburse the entity by providing it with a credit against payroll taxes for the cost of the subsidy. For assistance eligible individuals, the subsidy will not be treated as income or resources in determining an individual's eligibility for, or the amount of assistance or benefits provided under, any public benefit provided under federal or state law.

An assistance eligible individual is entitled to receive the subsidy for a period of up to nine months, but this may end earlier if any of the following occur: (i) the assistance eligible individual becomes eligible to participate in another group health plan,¹ (ii) the assistance eligible individual becomes eligible for benefits under the Social Security Act (Medicare), or (iii) the assistance eligible individual's COBRA eligibility terminates for any reason, including, but not limited to, failure by the assistance eligible individual to pay the required 35 percent share of the COBRA premium. Assistance eligible individuals are required to notify the group health plan when they are no longer eligible for the subsidy. Failure to do so may result in a financial penalty of 110 percent of the subsidy amount.

Funding the Subsidy

The subsidy is funded by the federal government through offsets to the payroll taxes of the employer, plan sponsor, COBRA administrator, insurer or other entity receiving the 35 percent share of the COBRA premium from the assistance eligible individual. Once the entity receives the assistance eligible individual's premium payment, the entity is instructed to reduce its payroll taxes in an amount equal to the remaining 65 percent of

¹ This does not apply to coverage consisting of only dental, vision, counseling, or referral services (or any combination thereof), coverage under a flexible spending arrangement, or certain coverage of treatment in an on-site medical facility maintained by the employer.

the COBRA premium. If this form of reimbursement does not cover the amount of the subsidy, the Secretary of Treasury will provide the entity with a tax credit or a refund.² On Feb. 26, 2009, the Internal Revenue Service (the "IRS") issued a revised 2009 Form 941, which allows the entity to claim the subsidy credit when filing its quarterly employment taxes. To view the updated Form 941 and its instructions, please go to the following websites: <http://www.irs.gov/pub/irs-pdf/f941.pdf> and <http://www.irs.gov/pub/irs-pdf/i941.pdf>.

No additional information regarding the subsidy is required to be submitted with the Form 941, but employers (or the entity receiving the 35 percent share of the COBRA premium) are required to maintain supporting documentation for the credit claimed. This information includes, but is not limited to: (i) an attestation of involuntary termination of employment for each covered employee in which the entity is seeking the offset (involuntary terminations are explained in the "Eligibility" section of this Alert below), (ii) a calculation of payroll tax offsets or other documentation to verify the correct amount of reimbursement, and (iii) the social security numbers of all covered employees and the amount of the subsidy provided to each covered employee. The Department of Treasury and the IRS will publish further guidance regarding the reporting requirements and verification of offsets.

Reimbursement to Multiemployer Plans

For multiemployer plans that initially pay the subsidized portion of the assistance eligible individual's COBRA premium, but are not subject to payroll taxes, it appears that the government will reimburse those plans by providing them with a refund (rather than a payroll tax offset). The ARRA requires the Secretary of Treasury to issue regulations that provide additional guidance on this subject. In the interim, multiemployer plans should comply with the requirements of the ARRA's COBRA provisions, notice obligations and deadlines (as described in this Alert).

Eligibility

To be eligible for the COBRA premium subsidy, an individual must qualify as an "assistance eligible individual." A person is an "assistance eligible individual" if he or she is (i) involuntarily terminated from employment (for reasons other than gross misconduct) during the period beginning on Sept. 1, 2008, and ending on Dec. 1, 2009, and (ii) eligible for COBRA coverage (or applicable state continuation coverage (see the "Continuation Coverage under State Law" section of this Alert for more details)) during that period. The assistance eligible individual's qualified dependents are also eligible for the subsidy.

The ARRA also contains income limitations that determine to what extent an individual is eligible to receive the COBRA subsidy tax-free. Individuals designated as "high income individuals" will be taxed on the subsidy. Whether an individual is "high income" is based on that person's modified adjusted gross income shown on their federal income tax return during the taxable year in which the subsidy is taken, or the return of their spouse, or any person that claims the assistance eligible individual as a dependent. If an individual's modified adjusted gross income for the year in which he or she receives the COBRA subsidy exceeds the threshold amounts provided in the ARRA (\$145,000 for single filers and \$290,000 for joint filers), the subsidy will be fully recaptured on the individual's tax return during the year the COBRA premium subsidy is received by increasing the individual's taxes by the amount of the subsidy. For single filers whose modified adjusted gross income is between \$125,000 and \$145,000 (or \$250,000 and \$290,000 for joint filers) the amount of the subsidy that is recaptured on the tax return is subject to a sliding scale. To avoid this recapture tax, high income assistance eligible individuals may elect to permanently waive their right to the subsidy by giving notice to their former employer (or other plan sponsor). Because the election is permanent, once an individual provides this notice, he or she cannot later opt back in to the subsidy. The Department of Treasury will issue further guidance on this waiver.

Assistance eligible individuals who elected COBRA due to an involuntary termination on or after Sept. 1, 2008, but prior to the date of the ARRA's enactment (Feb. 17, 2009) are eligible for the subsidy on a prospective basis, beginning on the first period of COBRA coverage following Feb. 17, 2009. For employers that bill COBRA premiums monthly, this will be on or after March 1, 2009.

Assistance eligible individuals who were eligible to elect COBRA on or after Sept. 1, 2008, but did not timely elect COBRA, will receive a second opportunity to elect COBRA continuation coverage. Such individuals will

² For group health plans that are multiemployer plans, the plan will receive the refund. Ultimately, the entity that is responsible for "fronting" the subsidy amount will be the entity that receives the tax credit.

have 60 days from the date they receive the extended election notice to make this special election. If elected, the assistance eligible individual will receive subsidized continuation coverage on a prospective basis beginning on the first period of COBRA coverage following Feb. 17, 2009. The maximum COBRA coverage period, however, would be measured from the earliest date that COBRA coverage could have been elected. For example, if an assistance eligible individual was entitled to COBRA in September 2008, but did not timely elect it, he or she can now elect COBRA coverage under the ARRA. If he or she timely elects under the new rules, the COBRA subsidy would begin in March 1, 2009 (for monthly coverage plans), but his or her 18-month COBRA period would run from September 2008 (and not March 2009).

Alternative Coverage Option

Under the ARRA, employers are permitted, but not required, to allow assistance eligible individuals to change their health insurance coverage option from the one in which he or she had been enrolled at the time of the involuntary termination. The new coverage option must satisfy the following requirements:

- The option must be one that is offered by the employer to active employees;
- It must have the same or lower premiums; and
- It cannot include a flexible spending arrangement, coverage that provides only dental, vision, counseling, or referral services (or any combination thereof), or certain coverage of treatment in an on-site medical facility maintained by the employer.

Assistance eligible individuals must make this election to change within 90 days of their receipt of the COBRA election notice.

Notice Requirements

The ARRA requires employers and other COBRA administrators to amend existing COBRA election notices or provide a supplemental notice to *all* individuals who became entitled to COBRA coverage (regardless of the reason for such entitlement) during the period beginning on Sept. 1, 2008, and ending on Dec. 31, 2009. This additional notice must be provided to all affected individuals within 60 days of the date the ARRA was enacted (meaning no later than April 18, 2009). Failure to timely provide the notice may result in financial penalties. The new or supplemental notice must include the following:

- A description of the subsidy (including an explanation of the right to receive the subsidy and any conditions related thereto);
- The option to enroll in different coverage if the employer or COBRA administrator permits, and a description of the different coverage;
- A description of the forms necessary to receive the subsidized premium;
- Contact information for the employer or COBRA administrator;
- A description of the extended election period available to assistance eligible individuals who were eligible for COBRA on or after Sept. 1, 2008, but did not elect it; and
- A description of an assistance eligible individual's obligation to notify the employer or COBRA administrator if he or she becomes eligible for coverage under another group health plan or Medicare, and the financial penalties for failing to do so.

The Secretary of Labor will issue model notices no later than March 19, 2009.

Continuation Coverage under State Law

The new COBRA subsidy rules also apply to any state program that provides comparable health continuation coverage. Thus, New York employers that are not subject to COBRA because they have less than 20 employees, but are obligated to provide health continuation coverage pursuant to New York law, must provide the subsidy and comply with the requirements related thereto.

Employer's Denial of Subsidy & Expedited Review

An individual who requests the subsidy as an assistance eligible individual and is denied by the employer or COBRA administrator has the right to appeal the determination upon application to the Secretary of Labor (or the Secretary of Health and Human Services for continuation coverage provided pursuant to the Public Health Service Act). The Secretary will make a determination with respect to the individual's eligibility within 15 business days after receipt of the application.

Effective Date

The ARRA's COBRA provisions became effective on Feb. 17, 2009. To give employers and COBRA administrator time to comply with the new subsidy obligations, however, the ARRA provides a grace period of two full COBRA billing periods. As a practical matter, employers that bill COBRA premiums on a monthly basis will have March and April to modify their processes to comply with new rules by May. During the grace period, employers and COBRA administrators may charge assistance eligible individuals the full cost of their COBRA premiums, but are required to reimburse assistance eligible individuals (or credit subsequent COBRA billing periods) for premiums the individuals paid in excess of their 35 percent share during the grace period. Any credit should be made within 180 days from the date the assistance eligible individual overpaid his or her premium. If it reasonably appears that the assistance eligible individual cannot use the credit within 180 days, there are special rules requiring the employer or COBRA administrator to pay the assistance eligible individual any amounts owed within 60 days of the date the overpaid premium was made.

Employer Considerations for COBRA Subsidy

With the enactment of the ARRA and the new COBRA provisions, there are several questions that remain unanswered. For example, it is unclear whether the employer will receive a tax credit if it is paying all or a portion of a former employee's COBRA premiums pursuant to a separation agreement. The eventual publication of the regulations and model notices from the Department of Labor and Department of Treasury will likely shed some light on this issue and other complex topics surrounding the COBRA subsidy. In the interim, employers and/or COBRA administrators should prepare for these changes by doing the following:

- Identify individuals eligible for COBRA who were terminated on or after Sept. 1, 2008, and dependents of those individuals.
- Determine whether to revise existing notices or develop a supplemental notice.
- Coordinate with payroll and/or third party administrators to develop a process to reimburse or credit eligible assistance individuals who overpaid premiums during the grace period.
- Coordinate with payroll and/or third party administrators to develop a process to receive the offset to payroll taxes.
- Determine whether to offer former employees the option to elect alternative coverage.
- Be aware of important dates and deadlines, such as the following:

| IMPORTANT DATES & DEADLINES | |
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| Sept. 1, 2008, through Dec. 31, 2009 | If an individual qualifies as an assistance eligible individual during this period, he or she may be entitled to receive subsidized COBRA premiums, subject to the limitations contained in the ARRA and described in this Alert. |
| Feb. 17, 2009 | The ARRA signed into law; new COBRA provisions effective on this date. |
| March 1, 2009 | Most employers that charge COBRA premiums monthly will have to comply with the new subsidy rules as of this date, but will have a grace period of two full COBRA billing periods. |
| March 19, 2009 | The Department of Labor to issue model notices no later than this date. |

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| April 18, 2009 | On or before this date, provide new or supplemental notice to all individuals who were entitled to COBRA on or after Sept. 1, 2008. |
| May 1, 2009 | This will be the end of the grace period for most employers that charge COBRA premiums monthly. Employers and COBRA administrators are expected to be in full compliance with the COBRA provisions of the ARRA by this date. |

Both the Department of Labor and the IRS have developed websites that provide information on the subsidy. To view those websites, go to <http://www.dol.gov/ebsa/COBRA.html>, <http://www.irs.gov/newsroom/article/0,,id=204708,00.html> and <http://www.irs.gov/newsroom/article/0,,id=204505,00.html>.

We will provide an additional update when regulations are issued and as more information becomes available.

If you have any questions concerning this Alert, please contact:

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